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Statement of
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Before the
SUBCOMMITTEE ON HUMAN RESOURCES
HOUSE COMMITTEE ON POST OFFICE AND CIVIL SERVICE
[H.R. 4717 on]
CONTRACTING OUT OF FEDERAL FUNCTIONS
BY THE EXECUTIVE AGENCIES
H.R. 4717

HSE 00910

JMB
POD

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to share with the Subcommittee our views on contracting out of Federal functions by executive agencies.

You have introduced H.R. 4717 which, if enacted, would provide for adjustments to Federal personnel ceilings based upon the extent that Federal functions are contracted out. This bill is intended to clarify Government policy on the relationship between contracting out and personnel ceilings, and on yearend spending. We have reported to the Congress on a number of studies related to the basic issue underlying H.R. 4717--whether agencies of the Federal Government should perform functions directly, using their own employees, or contract with private enterprise for those functions.

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~~Federal Contracts~~
Personnel
Manpower
Proposed with their
Federal legislation
agencies

This issue has long been a subject of controversy involving the departments and agencies, the Congress, industry, and Federal labor unions. Since its establishment in 1955, the executive branch's policy of reliance on private enterprise to supply needed goods and services has undergone numerous changes.

Agency decisions to perform services directly, using their own employees, or to contract for those services are significantly influenced not only by personnel ceilings but also by other considerations, including personal services contract issues; Federal labor-management relations policies; legislation relating to obtaining goods and services from other Government agencies; Federal small business policy; Department of Defense policies for assigning military or civilian personnel; legislation relating to the use of Government arsenals; and the Federal printing policy.

For years Federal employment has been controlled primarily through personnel ceilings which the Office of Management and Budget (OMB) has established for each agency. Since fiscal year 1975 the Congress has set an additional ceiling on the Department of Defense (DOD). H.R. 4717 recognizes the statutory ceiling for the executive branch established by the Congress in the Civil Service Reform Act of 1978. 1/ Proposed legislation now before the Congress, such

1/Public Law 95-454, 92 Stat. 1155

as H.R. 4400, H.R. 4410 and S. 1410, would permanently reduce this ceiling at the rate of 2 percent a year for the next 5 years.

The Federal work force should be no larger than needed to do the work required to accomplish the programs and activities authorized by the President and the Congress. For the Government to be effective, its programs and activities must be effectively implemented. Sound implementation can be weakened by too many employees, resulting in costly nonproductivity, or by too few, resulting in an unmanageable workload and inadequate supervision of contractors. While we fully support the goal of an efficient streamlined work force, we believe the President and the Congress must carefully examine the impact of future personnel reductions on specific programs and activities.

If, because of personnel ceilings, agencies cannot directly hire enough people to accomplish their approved programs and activities, they must work the employees they have overtime and/or obtain the services of additional people indirectly through contracts with private firms or grants to institutions and State and local governments. These additional people are neither included in employment ceilings nor counted as part of the Federal work force, but must be paid from Federal funds, including the possibility of greater costs to the Government.

Emphasis on limiting the number of persons on the Federal payroll may obscure the reality that the Government incurs the cost of all manpower resources devoted to Federal programs even though many of the people are not on the Federal payroll.

The President and the Congress are concerned about the effective, efficient, and economical use of the Federal work force, but they lack assurance that the agencies would effectively control employment levels if they were not constrained by personnel ceilings. Resources need to be controlled. However, controlling only one element of the total manpower resources used involves the risk of distorting management decisions. Emphasis on managing direct employment through personnel ceilings, which apply to the last day of the fiscal year, rather than the total manpower resources used gives only the appearance of control.

Although personnel ceilings may be a tool to control the total number of Federal employees, ceilings are at best an inferior substitute for effective management. Management at all levels needs to aggressively seek ways to improve productivity and coordinate workload, funds, and manpower.

We frankly believe that personnel ceilings are a barrier to effective work force management. We have suggested that funding or program limitations may be an effective means of control. An agency can neither hire workers nor contract for them unless it has the funds. Additional controls

imposed by personnel ceilings deprive agency management of options for accomplishing essential work through the most effective, efficient, and economical use of the most appropriate type of manpower in specific circumstances.

The basic framework for a practical and effective alternative to yearend personnel ceilings already exists in the budget process. What is lacking is confidence in the soundness of agencies' estimates and in agency managers' willingness to adhere to their estimates. If the objective is to limit personnel costs, one way would be to limit the funds authorized for such costs.

With OMB's direction, the agencies could develop methods for preparing sound estimates of the minimum manpower requirements needed to accomplish all types of authorized programs and activities. The agencies should fully document the processes and data used and make this information available to OMB and concerned congressional committees for evaluation.

Since the budget process takes place every year and budget examiners and congressional committees and subcommittees monitor agency activities during the year, agency managers would be obligated to develop realistic estimates and avoid deviating substantially from them without approval.

Government competition with private enterprise has long been a controversial issue. For over 40 years congressional committees have made many studies of the extent to which

the Federal Government has competed with private enterprise in commercial or industrial activities.

In 1932 a special House committee made the first extensive study which found several commercial or industrial activities, created expressly for World War I needs, still in existence. Although the committee recommended terminating many of these activities, the Government expanded some and established new ones.

After World War II, congressional committees again directed their attention to commercial or industrial activities being performed by the Government as carryovers from the war years. Although military operations were their initial concern, studies of commercial activities of some civilian agencies were soon underway. The general finding of these studies was that the Government was involved in many unnecessary and nonessential competitive activities and that efforts should be made to discontinue any activity the private sector could provide with reasonable convenience and at fair and reasonable prices.

In September 1952 DOD issued the first in a long series of directives detailing policy and instructions for commercial or industrial facilities operated by the military departments. The directive stated a policy against retaining and operating such facilities where required needs could be effectively and economically met by existing facilities of any other military

department or by private commercial facilities. It also required the military departments to survey and justify continuation of existing facilities and restricted the establishment of new facilities.

In establishing the Commission on Organization of the Executive Branch of the Government in 1953, 1/ the Congress stated that it was its policy to eliminate nonessential services, functions, and activities which were competitive with private enterprise. In 1955 this Commission issued a series of reports which contained many recommendations designed to eliminate or substantially decrease those Government activities which were competing with private enterprise, and it urged the use of private contract services.

President Eisenhower's budget message of January 21, 1954, was apparently the first public statement of executive branch policy on Government competition with private enterprise. It stated:

"This budget marks the beginning of a movement to shift * * * to private enterprise Federal activities which can be more appropriately and more efficiently carried on in that way."

After months of study, in January 1955 the Bureau of the Budget (the predecessor of OMB) initiated a program to curtail some of the Federal Government's commercial or industrial activities.

1/Public Law 83-108, 67 Stat. 142. ✓

There is a need for a national policy directing how the Government will acquire its needed goods and services, endorsed and supported by both the legislative and executive branches. The national policy must be stable, understandable, and provide a balance among the many conflicting national objectives. Until Federal departments and agencies perceive that the policy is a firm national resolve, they will not carry it out effectively.

Over the years many bills have been introduced to legislate a Federal policy concerning Government operations that compete with private enterprise, but none have been passed. The executive branch has consistently opposed enacting of such a measure on the grounds that it has already adopted a policy and that the President and agency heads have authority to administratively implement such a policy.

The executive branch policy has evolved through a series of directives. Although the basic policy of relying on the private sector to supply the Government's needs has remained the same, the guidelines and implementing procedures have been modified. Following are examples of principal changes.

--The policy emphasis was originally directed toward eliminating or preventing Government commercial activities. It was later recognized that, under certain circumstances, there might be considerations

which would make it advisable or necessary for a Government agency to provide products or services for its own use.

--Under the initial phases of the program, procurement from commercial sources was strongly advocated without a comparison of relative costs unless the agency head concluded that the product or service could not be purchased on a competitive basis and at a reasonable price. This was later modified to recognize that, in some instances, commercial sources should be subjected to competitive disciplines, including the possibility of Government production for its own use.

The Office of Federal Procurement Policy (OFPP), established in OMB in 1974, 1/ provides overall procurement policy direction for executive agencies in accordance with applicable laws. One of its specific functions is

"* * * monitoring and revising policies, regulations, procedures, and forms relating to reliance by the Federal Government on the private sector to provide needed property and services * * *"

OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," restates the principle that it has been and continues to be the general policy of the Government to rely on competitive private enterprise to supply the products and services it

1/Public Law 93-400, August 30, 1974, 41 U.S.C. § 401,404. ✓

needs. The most recent revision of Circular A-76, issued March 29, 1979, states that this policy builds on three equally valid precepts:

"a. Rely on the Private Sector. The Government's business is not to be in business. Where private sources are available, they should be looked to first to provide the commercial or industrial goods and services needed by the Government to act on the public's behalf.

b. Retain Certain Governmental Functions In-House. Certain functions are inherently governmental in nature, being so intimately related to the public interest as to mandate performance by Federal employees.

c. Aim for Economy; Cost Comparisons. When private performance is feasible and no overriding factors require in-house performance, the American people deserve and expect the most economical performance and, therefore, rigorous comparison of contract costs versus in-house costs should be used, when appropriate, to decide how the work will be done."

The circular outlines several circumstances under which the Government may provide a commercial or industrial product or service for its own use.

H.R. 4717 refers particularly to contracting for personal services. The difficulty in attempting to define "personal services" is shown by the history of GAO legal decisions. In early Comptroller General decisions, the term "personal services" was used to include all services normally performed by Government employees or which could be performed by existing staff. Since those early decisions, however, we have recognized that agencies may contract services normally performed by Government employees if the agency

finds it is more feasible, economical, or necessary to have the services performed by non-Government parties. The contract must be with an "independent contractor" in which the Government and the contractor's personnel are not in an employer-employee relationship. Two Federal Courts of Appeals have also recently followed this approach and permitted agencies considerable discretion to perform services through independent contracts.

The bill would require each agency, within 10 days after entering into "any contract involving personal services," to report to OMB the number of employees that would have been required to perform the services in-house. The intent is to have OMB adjust the agency's personnel ceiling downward by the number of agency employees that would have been used if the services had not been contracted. In addition, the bill would allow an agency to ask OMB to increase its personnel ceiling to permit it to perform a particular function in-house rather than by contracting out. If the intent of H.R. 4717 is to increase the overall Government ceiling, this intent should be expressly stated in the bill.

A major problem encountered in estimating the costs of an in-house operation is determining the number of persons needed to accomplish a given workload. Since many activities covered by Circular A-76 are highly labor intensive,

estimates of labor costs are critical to the outcome of cost comparisons. Labor costs are influenced by several different items, such as:

- Amount of work to be performed.
- Productivity of the work force.
- Number and skills of personnel needed.
- Wage rates.
- Associated labor costs (retirement factor).

Difficulties in estimating all of these items could result in both understatements and overstatement of in-house labor costs.

Agencies also have many problems determining contract costs. Past methods of estimating, or obtaining informational quotes of, contract costs have been unreliable. To remedy this problem, OMB now requires that contract costs must be based on a binding firm bid or proposal solicited in accordance with pertinent acquisition regulations.

We share the Subcommittee's concern that executive agencies determine, where practicable, the most cost effective means of accomplishing their essential functions. We also share the Subcommittee's concern about the constraints personnel ceilings impose on the agencies. The longstanding controversy over whether the Government should produce its

own needed goods and services or contract with private enterprise for them deserves explicit treatment by the Congress. We suggest that the Congress, through legislation or otherwise:

- Establish a national policy with respect to the extent to which the Government should rely on private enterprise, to the maximum extent feasible and insofar as this is consistent with the national interest, within the framework of reasonable prices.
- Direct reviews of existing legislation relative to the Government's make-or-buy decision to identify and eliminate potential sources of conflicts and inequities, as pointed out in our September 25, 1978, report. 1/
- Recognize that the Government bears the cost of all types of manpower used for Federal programs and activities, and direct the executive branch to develop effective funding or budgetary controls as an alternative to the political expediency of personnel ceilings.

To assure that contracting out of Federal activities which could be performed by Federal employees is undertaken in an orderly manner and in accordance with otherwise applicable rules and procedures, H.R. 4717, if enacted, would provide that not more than 20 percent of the appropriations of any executive agency which are appropriated for the fiscal year may be obligated during the last 2 calendar months of that fiscal year.

1/Development of a National Make-or-Buy Strategy--Progress and Problems (PSAD-78-118).

The problems associated with yearend surges in Government spending--disruption of orderly funding of Government operations, bypassing certain procurement controls, and inflationary impact on the economy--are of concern to both the legislative and executive branches. Congress has limited yearend obligations in a few appropriations. We have had requests to review yearend spending practices, the most recent being this Subcommittee's request of May 29, 1979.

In 1977 and 1978 the President requested the heads of executive departments and agencies to issue instructions curtailing yearend spending and tell their staffs not to spend or obligate funds for the sole or primary purpose of keeping them from lapsing. He felt that the need to avoid unneeded or unwise Federal Government spending was more important than ever in this time of high inflation. In 1979 the Director, OMB, issued more detailed instructions to control yearend spending.

In accordance with this Subcommittee's May 29, 1979, request, we have initiated a review at civilian agencies to determine:

1. How the agencies, covered by our 1977 report on research and development contracts (PSAD-77-66), have improved the distribution of their spending on contracts to profit-making firms.

2. Whether adequate justification exists for the increase in spending by the Department of Health, Education, and Welfare (HEW) for consultant fees and services during the last quarter of the fiscal year.

3. Whether there is a significant increase in grants and other noncompetitive awards toward the end of the fiscal year in selected agencies within HEW and other departments.

4. What specific legislative recommendations are feasible to control yearend spending sprees.

We are making our review at the Departments of HEW, Housing and Urban Development, Commerce, and Interior, and at the Environmental Protection Agency. At the sites we have visited so far, we have found no central reporting system within these agencies that readily identifies which activities are responsible for surges of yearend obligations.

We plan to report on our review by June 30, 1980, and will be better prepared then to make recommendations for corrective action. In the interim, we plan to work with the Subcommittee and offer suggestions, if requested, on the specific language to be incorporated into legislation or regulations.

This completes our formal statement, Mr. Chairman. I will be glad to respond to any questions.